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In the

Supreme Court of the United States

OCTOBER TERM 1964

No. 899

MURPHY OIL CORPORATION,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

AMICUS CURIAE BRIEF IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

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The Petition for Writ of Certiorari should be granted to resolve the conflict between Courts of Appeal on an important question of Federal tax law that has not been, but should be, settled by this Court, consistent with fundamental principles announced by this Court in prior decisions which will require a reversal of the decision below, and because an additional conflict exists between the Court of Appeals for the Fifth Circuit on the one hand and the Court of Appeals for the Eighth Circuit and the Tax Court on the other hand as to the meaning of this Court's decision in Burton-Sutton Oil Co. v. C.I.R., 328 U.S. 25, and its application to the issue presented in the instant case 2

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CONSENT OF PARTIES

This amicus curiæ brief in support of the Petition for Writ of Certiorari is filed with the consent of the parties herein. Letters from the respective counsel for petitioner and respondent granting such consent have been filed with the Clerk of this Court.

INTEREST OF AMICUS CURIAE

The question presented herein is identical to one of the issues presented in Cause No. 21,067 in the United States Court of Appeals for the Fifth Circuit, styled *The Shamrock Oil and Gas Corporation, Petitioner, v. Commissioner of Internal Revenue, Respondent*, submitted and orally argued February 22, 1965, on petition to review the de-

cision of the Tax Court of the United States in *The Shamrock Oil and Gas Corporation v. Commissioner of Internal Revenue*, 35 T.C. 979. The undersigned attorney filing this amicus curiæ brief is counsel of record for the petitioner in *The Shamrock Oil and Gas Corporation* case. Because of the identity of issues presented in the instant case and in *The Shamrock Oil and Gas Corporation v. Commissioner of Internal Revenue*, the undersigned attorney and his client, though having no interest in this case, are vitally interested in the final result of these proceedings. This amicus curiæ brief is presented on behalf of the undersigned attorney and his client, The Shamrock Oil and Gas Corporation.

ARGUMENT

The issue herein, decided by the Eighth Circuit, and pending in the Fifth Circuit in the *Shamrock* case, presents an important question of Federal tax law which has not been, but should be, settled by this Court, not only because of the importance of such question, but because of the conflict in the decisions between the United States Courts of Appeal for the Eighth Circuit and the Fifth Circuit and the conflict between the decision herein and the fundamental concepts of tax law announced by this Court in the hereafter cited cases.

The question, presented herein, of how a lessee should treat, for Federal income tax purposes, cash bonuses paid for the acquisition of an oil and gas lease is of substantial importance, not only to the oil and gas industry but to the

Commissioner of Internal Revenue which, it is submitted, can only be resolved by an opinion of this Court settling the disagreement between such Courts of Appeal as to the application of this Court's decision in *Burton-Sutton Oil Company v. Commissioner of Internal Revenue*, 328 U.S. 25, to the lessee's tax treatment of a cash bonus. On this issue the Court of Appeals for the Eighth Circuit in the instant case, as well as the Tax Court in *The Shamrock Oil and Gas Corporation v. Commissioner*, 35 T.C. 979, are in direct conflict with the Court of Appeals for the Fifth Circuit in *Lambert v. Jefferson Lake Sulphur Company*, 236 Fed. 2d 542, affirming *Jefferson Lake Sulphur Company v. Lambert* (E.D.La.) 133 Fed. Supp. 197.

In the *Jefferson Lake Sulphur Company* case, the Fifth Circuit concluded that this Court's decision in *Burton-Sutton Oil Company*, supra, had rejected the Government's contention, made in the *Jefferson Lake Sulphur Company* case (likewise made by the Government in the instant case, and adopted by the Eighth Circuit herein), that cash payments made for the acquisition of a lease were "bonuses recoverable only through depletion." The decision of the Eighth Circuit, as well as the District Court in the instant case, take the directly opposite view that this Court's decision in *Burton-Sutton Oil Company* is not applicable to cash bonuses and is not decisive of the issue raised herein.

It is true that *Burton-Sutton Oil Company* involved a net profits payment rather than a cash bonus, but the fundamental principles determining the tax liability, as between the lessee-payor and the lessor-recipient of a

cash bonus and of a net profits payment, are the same. The decision in *Burton-Sutton Oil Company* is not to be disregarded in deciding the instant case merely because it involved a net profits payment rather than a cash bonus, since this Court's decision in *Burton-Sutton Oil Company* is founded on a determination of which of the parties payor and payee held the economic interest in the property.

It is submitted that the decisions of the Eighth Circuit and of the District Court in the instant case are wrong, and that the decisions of the Fifth Circuit and of the trial court in *Jefferson Lake Sulphur Company* are correct, but in either event, because of the conflicting views as to the application of this Court's opinion in *Burton-Sutton Oil Company*, the petition for writ of certiorari should be granted in order that the uncertainties surrounding this important question of Federal tax law may be clarified and decisively settled by a decision and opinion on the merits. A denial of the petition for certiorari would leave unsettled the issue presented in the instant case and in *The Shamrock Oil and Gas Corporation v. Commissioner* since, under the established practice of this Court, such a denial is not a precedent for like action in a similar case.

Under the decisions of the Court of Appeals and the trial court herein, as well as the decision of the Tax Court in *The Shamrock Oil and Gas Corporation*, a cash bonus payment, though treated as an advance royalty when received by the lessor-payee suddenly "constitutes a capital investment in the property recoverable only through the depletion allowance" (Reg. 118, Sec. 39.23(m)-10(a)) as to the lessee-

payor, which cannot be excluded or deducted when lessee-payor computes his taxable income. However, when the lessee so treats such payment as a capital investment and computes his depletable income, such payment suddenly becomes a royalty which must be deducted from the gross income from production on an allocate basis, based on the anticipated productive life of the lease, before computing income subject to the statutory depletion allowance (Reg. 118, Sec. 39.23(m)-1(f)(5)), even though the lessee is required by Sec. 114(b)(3) of the 1939 Revenue Code to take percentage depletion instead of cost depletion where percentage depletion is greater.

The effect of the Regulations and decision herein is acknowledged in the trial court's opinion in the instant case and by the Tax Court in the *Shamrock* case to deprive the lessee of the right of recovering the cash bonus payment through the percentage depletion allowance, even though the lessee is required to treat such bonus payment as a capital investment and not as an advance royalty to be excluded or deducted in computing taxable income. This result is contrary to the provisions of Sec. 23(m) and Sec. 114(b)(3) of the Internal Revenue Code of 1939 providing for the depletion allowance and should not be allowed to stand.

The inconsistent treatment of the same bonus payment as an advance royalty to lessor and a capital investment by lessee, and the further inconsistent treatment as to the lessee of the same bonus payment as both a capital investment and as a royaly results in taxing the lessee on income that has already been taxed to the lessor as an advance royalty.

Burton-Sutton Oil Company repudiates such absurd result and outlines the guide lines for determining the issue here presented. The Fifth Circuit's opinion in *Jefferson Lake Sulphur Company* follows such guide lines while the opinions below in the present case assert such guide lines are not applicable or controlling with respect to cash bonus payments.

A cash bonus paid by a lessee to a lessor and royalties payable on production to a lessor under an oil and gas lease are both consideration for the lease and income to the lessor. *Burnet v. Harmel*, 287 U.S. 103. Insofar as the lessor is concerned, there is no distinction between a bonus and a royalty and both constitute ordinary income subject to depletion in the hands of the lessor. *Burnet v. Harmel*, supra; *Murphy Oil Company v. Burnet*, 287 U.S. 299; *Palmer v. Bender*, 287 U.S. 551; *Herring v. Commissioner*, 293 U.S. 322; *Anderson v. Helvering*, 310 U.S. 404; *Douglas v. Commissioner*, 322 U.S. 275.

This consistent treatment of bonuses and royalties as to a lessor was extended to a net profits payment received by a lessor in *Kirby Petroleum Company v. C.I.R.*, 326 U.S. 599. In *Burton-Sutton Oil Company v. C.I.R.*, supra, this Court held a net profits payment paid by a lessee was deductible in computing its taxable income. This Court grounded its decision in *Burton-Sutton Oil Company* on the economic interest concept and held, since the lessor held the economic interest in the property and must look to the income from the property for a return of its capital investment, that the net profits payment must be treated as ordinary income to

the lessor, subject to the depletion allowance, and the lessee-payor of such net profits payment could and should deduct such payment from the gross receipts or taxable income.

There is an exact parallel between bonus payments and net profits payments as was recognized by the Court of Appeals in *Lambert v. Jefferson Lake Sulphur Company*, supra, and the District Court in such case, *Jefferson Lake Sulphur Company v. Lambert*, 133 Fed. Supp. 197, where this Court's opinion in *Burton-Sutton Oil Company* was held controlling as to the lessee's treatment of cash bonus payments as well as lessee's treatment of net profits payment. The contrary view is taken by the courts below in the instant case. The Court of Appeals herein takes a narrow view of this Court's decision in *Burton-Sutton Oil Company* and looks only to two sentences from this Court's opinion, 328 U.S. at page 27, i.e.:

> "If they are capital investments to one, they are capital sales to the other. If they are rents and royalties paid out to one, they are rents and royalties received by the other."

The Eighth Circuit Court opinion refers to these sentences as presenting a "broad generalization", and questions the accuracy of such sentences in Footnote 1 to the Court of Appeals opinion. The Fifth Circuit, as did the District Court in *Jefferson Lake Sulphur Company*, takes a broader view of the holding in *Burton-Sutton Oil Company*, to which it is believed such opinion is entitled, and ascribes to such sentences the full effect to which they are entitled, both

when standing alone and when read in the context of the entire decision.

All incongruities resulting from the inconsistent treatment of a cash bonus first as lessee's capital investment and then as a royalty in respectively determining the lessee's taxable and depletable income would be eliminated by recognizing, as the Fifth Circuit recognized, consistent with this Court's opinion in *Burton-Sutton Oil Company*, that such payment is an advance royalty as to the lessee who pays it just as it is consistently held to be an advance royalty to the lessor who receives it. If this were done, the cash bonus, like other royalties, would be taxed to the lessor as ordinary income subject to depletion, the lessee would exclude such payment from his taxable income and would exclude, under existing regulations, an allocate part of such payment from the proceeds of the oil or gas, as produced, in determining lessee's income from production on which the depletion allowance is to be computed.

If, on the other hand, contrary to the principles announced by this Court in the before cited cases, the cash bonus is finally held to be lessee's capital investment, then the lessee should not be deprived of his right to recover such investment, through statutory depletion, by holding the very same payment has suddenly become a royalty to be deducted from the income from production before computing percentage depletion on the remaining income and thereby defeating the lessee's right to recover his capital investment (if such it be) "through the depletion allowance."

It is submitted that regardless of the ultimate disposition of the issue presented herein, such important question of Federal tax law will not be settled until this Court has, by an opinion, directly passed upon the lessee's proper treatment, for Federal tax purposes, of a cash bonus paid for the acquisition of an oil and gas lease to one who retains an economic interest in the leased property. The conflict in the decisions in the Eighth and Fifth Circuits and the disagreement between such Courts of Appeal as to the meaning and effect of this Court's decision in *Burton-Sutton Oil Company* cannot be resolved without an opinion by this Court.

CONCLUSION

For all of the reasons herein assigned, it is respectfully submitted that this Court's discretion should be exercised in favor of granting the Writ of Certiorari that has been applied for in order that there may be a final disposition of a troublesome question of substantial import consistent with the prior opinions of this Court.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, W. M. SUTTON, Amicus Curiæ, and a member of the Bar of the Supreme Court of the United States, hereby certify that on the 29 day of March, 1965, I served copy of the foregoing Amicus Curiæ Brief in Support of the Petition for Writ of Certiorari on the Solicitor General, Department of Justice, Washington 25, D. C., and upon an attorney of record who represented the United States of America, Respondent in these proceedings, in the Court whose judgment is sought to be reviewed, and upon Vester T. Hughes, Jr., counsel for Petitioner, Murphy Oil Corporation, by Air Mail postage prepaid, by depositing same in the United States mail, properly addressed.

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